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SUBJECT: INFLATION, EXACERBATED BY SNOWSTORMS, HITS A NEW 11-YEAR  
HIGH

REF: 07 BEIJING 6286

SUMMARY

1. (SBU) China's National Bureau of Statistics announced today that consumer inflation reached a new eleven-year high of 7.1% in January. This may well be followed by an even higher figure for February that would be released on March 11, while the National People's Congress (NPC) is in session. Once again, agricultural prices explain most (85%) of the spike, the impact of which is felt disproportionately in poor and rural areas where families spend more of their budget on food. The increase came despite price controls and other price-related measures announced in January. The recent round of elevated inflation began last July, and economists have predicted for months that it would soon subside, only to be surprised at its persistence. There is a risk going forward that inflationary expectations will take root among consumers, dragging out this period of elevated inflation. END SUMMARY

INFLATION SPIKE CONTINUES

2. (SBU) China's National Bureau of Statistics announced today that consumer inflation reached a new eleven-year high of 7.1% in January. Food prices accounted for 85% of the increase; non-food inflation was 1.5%. Producer prices rose 6.1%, driven by raw materials and transportation bottlenecks and pointing to possible further inflation pressures ahead. February figures -- to be released March 11 during the NPC -- may be even higher because of snowstorm effects not captured in the January numbers, according to several economists. The increase came despite price controls and soft measures announced in January. The State Council, in an apparent bid to curb inflation expectations, had announced there would be no price increases for goods already controlled (e.g., energy and utilities), that large producers would need approvals to raise food prices, and that retailers would have to notify authorities if they raised certain categories of food prices beyond stated thresholds.

SURPASSING EXPECTATIONS

3. (SBU) The persistence of the CPI increases is a surprise. A look back at predictions from last fall shows major investment bank economists at outfits like CICC, JP Morgan, and RBS describing the CPI as at its likely peak. Economists at Chinese think-tanks took a similar view but placed more emphasis on the danger of fanning inflationary expectations (reftel). Chinese Government officials,

some speaking on the margins of the 17th Party Congress in October, also raised the potential for igniting inflationary expectations (e.g., demand for higher wages that would lead to further inflation), but gave little attention to the possibility that food price increases could drag out for this extended period.

EXPECT MORE

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14. (SBU) There are several reasons more inflation-related headlines are likely in the coming months. Food prices are still rising in the wake of snowstorm damage. Producer price inflation is also on the rise, suggesting that energy and raw material prices have yet to fully play out on the consumer side here. The locally-based Bank of America economist predicts a 7.8% figure for the February CPI as a result. Despite ongoing monetary "tightening," the rates of money supply and credit growth are still very high (e.g., 20-month high for the money supply increase in January). Finally, the longer that price hikes are sustained, the greater the risk of inflationary expectations settling in, leading to secondary effects later on.

RURAL EFFECTS

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15. (SBU) A valued academic economist contact expressed concern to us today about disproportionate effects in the countryside. Measured inflation is already higher in rural areas (7.7% last months vs. 6.8% in urban areas), and rural families spend more of their budgets on food. The economist commented that the widespread view that farmers are benefiting from higher prices is misplaced: the effects are highly variable across the country and now, in the wake of the snowstorms, many farmers are contending with crop damage. Further, farmers must contend with rising transportation costs and infrastructure bottlenecks, he said.

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